

CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM BOARD OF ADMINISTRATION INVESTMENT COMMITTEE

MINUTES OF MEETING OPEN SESSION

February 14, 2006

The Investment Committee met on Tuesday, February 14, 2006 in the Lincoln Plaza North Building, 400 Q Street, Auditorium, Sacramento, California.

The meeting was called to order at approximately 9:10 a.m. and the following members were present:

Charles Valdes, Chair
George Diehr, Vice Chair
Philip Angelides, represented by John Hiber
Marjorie Berte
Robert F. Carlson
Rob Feckner
Priya Mathur
Michael Navarro, represented by Debbie Endsley
Kurato Shimada
Maeley Tom
Steve Westly, represented by Karen Greene Ross

Investment Committee members excused: Tony Oliveira Mike Quevedo, Jr.

AGENDA ITEM 2 - APPROVAL OF AGENDA

The agenda was approved and there were no changes to the agenda order.

AGENDA ITEM 3 – APPROVAL OF DECEMBER 2005 MEETING MINUTES

Mr. Hiber requested that the minutes be amended to include the Treasurer's full recusal statement for the R Street Subcommittee Report at the December 12, 2005 meeting.

On **MOTION** by Shimada, **SECONDED** and **CARRIED** that the December 12, 2005 Open Session minutes be approved as amended.

Ms. Berte abstained.

AGENDA ITEM 4a – REAL ESTATE, R Street Subcommittee Report

Mr. Hiber stated "The Treasurer has disqualified himself from participating in, making or attempting to influence any CalPERS decisions regarding residential development within the R Street Project area, including any update on residential development during the R Street Subcommittee report to be made during open session, Item 4a, on February 14, 2006. In February 2005 Bill Cummings became a source of income to the Treasurer for purposes of the Political Reform Act. Based on information provided by CalPERS in response to inquiry from the Treasurer's Office, it's come to our attention that Mr. Cummings owns property within the R Street Project area. Therefore, in an abundance of caution, the Treasurer will disqualify himself from this matter." The Treasurer's representatives left the room for this item.

Diana Proctor, Project Manager, presented the February 10, 2005, R Street Subcommittee meeting summary, which included information regarding the February 2 public meeting sponsored by CalPERS, the City of Sacramento, CADA, the Department of General Services, and other developers. The purpose of the meeting was to discuss the entire R Street Corridor.

The Committee accepted the information report.

AGENDA ITEM 5a – ALTERNATIVE INVESTMENT MANAGEMENT (AIM) PROGRAM, California Initiative Update

Leon Shahinian, Senior Investment Officer, and Joncarlo Mark, Senior Portfolio Manager, presented the item.

The primary objective of this program is to earn attractive risk-adjusted rates of return. As an ancillary benefit to the investments made, the Program is expected to have a positive impact on underserved markets in California. Staff provided a presentation highlighting both financial results as well as the ancillary benefits assessment on the Program to date.

Third-party consultants, hired in 2005 to assist with efforts to ensure that CalPERS' partners were adhering to stated Program investment objectives, contributed to the presentation. The representatives were:

- Donn Cox, LP Capital Advisors
- Pete November, Pacific Community Ventures
- Beth Sirull, Pacific Community Ventures

The Committee accepted the information report. In addition, the Chair directed staff to provide another update as soon as feasible, incorporating input received from the Committee.

AGENDA ITEM 6a – GLOBAL EQUITY, New Enhanced Indexing Initiative

Christy Wood, Senior Investment Officer, and Mary Cottrill, Senior Portfolio Manager, presented the item. Michael Schlatcher, Wilshire Associates, was available to respond to questions from the Committee.

This was an action item seeking approval for staff to conduct an RFP for relaxed-long enhanced index U.S. equity managers. This strategy would complement the existing lineup of domestic active and enhanced equity strategies. The strategy expands the available opportunity set by allowing managers to exploit security mispricing for both overpriced and underpriced securities. The strategy should improve returns while reducing risk to the overall program.

On **MOTION** by Ms. Mathur, **SECONDED** and **CARRIED** to approve the issuance of a Request for Proposal with spring-fed pool and annual review contract features for relaxed-long enhanced index managers. Staff will seek Investment Committee approval for the entire recommended group of managers.

AGENDA ITEM 6b – GLOBAL EQUITY, Legislative Reports: Holocaust Era and Northern Ireland Annual Reports

Anne Stausboll, Interim Chief Investment Officer, presented the item.

There was discussion regarding clarification of the moratorium on the statutes requiring the reports, Legal Office advice to continue to comply with the monitoring portions of the statutes, and the Committee's decision last year to provide the Legislature with the executive summary of the reports and also post them on the CalPERS website.

On **MOTION** by Mr. Feckner, **SECONDED** and **CARRIED** to approve Holocaust Era and Northern Ireland Reports for transmittal to the Legislature.

Based on the direction from the Committee last year, staff also prepared letters to companies identified in the reports.

On **MOTION** by Ms. Greene Ross, **SECONDED** and **CARRIED** to forward letters to companies identified in the reports as having unresolved claims or otherwise requiring corrective action.

Mr. Feckner voted no.

AGENDA ITEM 6c – GLOBAL EQUITY, Executive Compensation Strategic Plan Update

Christy Wood, Senior Investment Officer, and Dennis Johnson, Senior Portfolio Manager, presented the item. Tom Lussier, CalPERS Federal Liaison, was available telephonically to respond to questions from the Committee.

This agenda item is the second update of CalPERS' progress to implement executive compensation reform as it pertains to the macro economic strategies of CalPERS' three-year Executive Compensation Strategic Plan. Staff provided a detailed update on each of the following three strategies.

- 1. SEC engagement
- 2. SRO / exchange engagement
- 3. Compensation consulting industry engagement

During the staff presentation Bridgette Butler, Investment Officer, was acknowledged for her contribution to the execution of the executive compensation plan.

The Chair directed staff to provide additional information to the Committee on staff's engagement with the compensation consulting community.

There was a lengthy discussion during which Committee Members commented about support of efforts to enhance disclosure and strengthen our efforts to crack down on executive pay abuse, issues regarding restated earnings and claw-backs, and that CalPERS engage with CII to ensure consistency in preparation of the CalPERS comment letter on SEC proposal.

On **MOTION** by Ms. Greene Ross, **SECONDED** and **CARRIED** to require staff to report back with a proposal for including a policy on claw-back provisions in the proxy voting guidelines.

The Chair further directed staff to report back regarding other possible actions to be taken with respect to claw-back agreements.

The Chair directed that the matter of whether to support U. S. Representative Barney Frank's "Protection against Executive Compensation Abuse Act" be agendized for the March Board of Administration meeting.

AGENDA ITEM 6d – GLOBAL EQUITY, Update on Investments in Companies Doing Business in the Sudan

Christy Wood, Senior Investment Officer, and Dennis Johnson, Senior Portfolio Manager, presented the item. Tom Lussier, CalPERS Federal Liaison, was available telephonically to comment during the discussion.

Staff provided an update on their progress to identify and engage portfolio companies doing business in Sudan. Staff continues to carry out the Investment Committee's constructive engagement plan through company and federal engagement, OFAC monitoring, and commitment to identify new and reliable sources to identify and engage companies doing business in Sudan.

There was additional discussion regarding the strategy to address this important issue and the pros and cons of divestment of companies doing business in Sudan.

On motion by Mr. Hiber to bring back to the Board for consideration in March a proposed policy of divestment on investments in Sudan. There was no second to the motion.

The Committee accepted the information report.

AGENDA ITEM 6e – GLOBAL EQUITY, Corporate Governance Staff Working Group Update

There were no items to report.

AGENDA ITEM 6f – GLOBAL EQUITY, Permissible Equity Market Investment Analysis Update

Christy Wood, Senior Investment Officer, and Mary Cottrill, Senior Portfolio Manager, presented the item. A revised agenda memo was distributed to the Committee.

Roz Hewsenian, Wilshire Associates, presented the updated draft Permissible Equity Markets Investment Analysis. On January 31, 2005, the exposure draft was placed on the CalPERS website and mailed to the Washington, DC embassy of each evaluated country and to the head of each country's primary stock exchange. There will be an interim posting in March, and the final policy will be presented at the April Committee meeting allowing each country time to review and comment on the analysis prior to the Committee's adoption.

It was noted the 2006 analysis reflects two changes relating to scoring methodology that the CalPERS Investment Committee approved in 2005: (1) all of the macro- and subfactors were evaluated on a 1-decimal place rating system, and (2) country factors were rounded to 1 decimal place. The only resulting significant change is that Sri Lanka fell below the 2.0 demarcation. There are no indications at this time that any country intends to file a remonstration.

The Chair directed staff to report back at a future meeting regarding the possibility of investing in ADRs/GDRs (American Depository Receipts and Global Depository Receipts) from prohibited markets that trade on the exchanges of permissible markets.

The meeting recessed from 11:10 to 11:20 a.m.

AGENDA ITEM 6g – GLOBAL EQUITY, Manager Development Program II Update

Christy Wood, Senior Investment Officer, presented the item. Staff provided a Program update regarding the status of contracts with the spring-fed pool of advisors selected in June 2005.

The Committee accepted the information report.

AGENDA ITEM 7a – GLOBAL FIXED INCOME, Credit Enhancement Program Annual Review

Curtis Ishii, Senior Portfolio Manager, and Daniel Kiefer, Portfolio Manager, presented the item. Staff provided a Program update noting that due to the aggressive pricing conditions within the market over the last 18 months, staff and CalPERS' partner Bank of New York (BONY) chose to underwrite fewer transactions and commit less capital to the market while maintaining a disciplined approach to those deals in which CalPERS participates. Staff reviewed a variety of initiatives that are expected to add value to the program over the next 6 to 12 months.

The Committee accepted the information report.

AGENDA ITEM 7b – GLOBAL FIXED INCOME, International Fixed Income RFP Request with Spring-Fed Pool

Curtis Ishii, Senior Portfolio Manager, and Eric Busay, Portfolio Manager, presented the item. Peter Mixon, General Counsel, and Roz Hewsenian, Wilshire Associates, were available to respond to questions from the Committee.

Staff provided the following external manager update:

- Barings announced the departure of portfolio manager Ed Britain. No impact to the CalPERS portfolio is expected.
- State Street Global Advisors announced the appointment of Lori Dryden as a senior portfolio manager. She may have future involvement with the CalPERS portfolio.

A search for active international fixed income mangers is one of the Global Fixed Income investment policy and structure goals for 2005-2006 and issuing an RFP for these managers is the next step in completing the objective of capturing risk controlled excess returns in a more effective manner.

There was discussion regarding the Committee's involvement with the interviews, whether they should be conducted in open or closed session, and the scoring process.

On **MOTION** by Ms. Mathur, **SECONDED** and **CARRIED** to approval issuance of a Request for Proposal with a spring-fed pool feature for active international fixed income managers. The Committee will delegate scoring to staff, with staff returning to the Committee with a final list of managers for approval.

Staff will recommend to the Policy Subcommittee amendments to the current active international fixed income managers management policy.

AGENDA ITEM 8 - POLICY SUBCOMMITTEE REPORT

Anne Stausboll, Interim Chief Investment Officer, presented the item.

By consent the Committee approved:

- a. Real Estate Policies
 - 1) Revision of Equity Real Estate and Revision of Opportunistic Real Estate
 - 2) Revision of Equity Real Estate Leverage
- b. Equity Policy
 - 1) Adoption of International Enhanced Index Strategy Externally Managed
- c. Fixed Income Policy
 - 1) Revision of Dollar-Denominated Fixed Income Short Duration Investment

The Chair directed that going forward only the redlined version of revised policies be included in the Committee agenda item.

AGENDA ITEM 9a – CHIEF INVESTMENT OFFICER'S / ASSISTANT EXECUTIVE OFFICER'S REPORT, Consolidated Investment Activity Report

Anne Stausboll, Interim Chief Investment Officer, presented the item.

The Committee accepted the Consolidated Investment Activity Report. The total market value of the fund as of December 31, 2005, was approximately \$200.9 billion and the total book value was approximately \$158.3 billion.

AGENDA ITEM 9b - CHIEF INVESTMENT OFFICER'S / ASSISTANT EXECUTIVE OFFICER'S REPORT, Selection of Master Custodian

Anne Stausboll, Interim Chief Investment Officer, presented the item.

A cross-divisional team comprised of staff from the Investment Office, Fiscal Services Division, Information technology Services Branch, Legal Office, and Operation Support Services Division, was established to develop the Request for Proposal, review proposals, conduct vendor interviews, on-site visits, and score the vendors.

The selection process began in August 2005 with the release of the RFP. Based on the final scores, the CalPERS Investment Office selected State Street Bank & Trust as the Master Custodian, subject to successful contract negotiations.

The Committee accepted the information report.

AGENDA ITEM 10 - DRAFT MARCH 2006 AGENDA

The Committee accepted the proposed March 13, 2006 agenda.

AGENDA ITEM 11 – PUBLIC COMMENT

There were no comments from the public.

The meeting was adjourned at 11:45 a.m.

The next meeting of the Committee is scheduled for March 13, 2006 in Sacramento, California.

FRED BUENROSTRO
Chief Executive Officer